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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC

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| In the Matter of: | ) | |
| | ) | |
| Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation | ) | MM Docket No. 93-215 |
| and | ) | |
| Adoption of a Uniform Accounting System for Provision of Regulated Cable Service | ) | CS Docket No. 94-28 |

**RESPONSE OF THE**
**UNITED STATES TELEPHONE ASSOCIATION**
**TO PETITIONS FOR RECONSIDERATION**

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# SUMMARY

In their Petitions for Reconsideration, Comcast and CVI claim that cable operators face greater risk than telephone companies and argue that the FCC is unjustified in setting an identical rate of return for the two industries. These views are simply mistaken. LECs face significant business risks as the local telephone market evolves to full competition. Competition in the telephone industry is a reality and a predominant factor in the minds of investors. In fact, the cable industry has announced plans to enter the telephone market. The FCC's chairman recently applauded these cable industry efforts.

LECs also face significant regulatory risks. Universal telephone service was built upon a regulatory structure in which basic exchange service was subsidized by other services. These subsidies cannot be sustained in a competitive market. Public policymakers must replace them with explicit support mechanisms that are competitively neutral and sustainable. Until such a solution is implemented in the regulatory arena, the local exchange industry faces immense regulatory risks.

Finally, USTA proposes a simple and workable solution to the difficult problem of cable company intangible assets. The FCC has adopted a complex system of presumptions that the cable companies now challenge. Instead, the FCC should consider a transition mechanism in which cable companies would amortize

"pre-regulation" intangibles. Going forward, new intangibles would be treated the same way for telephone and cable companies. USTA's proposal both responds to the concerns of the FCC about adverse impacts on the cable industry and achieves regulatory parity between telephone and cable companies.

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**RESPONSE OF THE**
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In response to the FCC's notice contained in the Federal Register on June 1, 1994, the United States Telephone Association (USTA) submits the following comments on three Petitions for Reconsideration filed by Comcast Cable Communications (Comcast), Cablevision Industries (CVI) and Bell Atlantic.[1] USTA is the principal trade association of the local exchange telephone industry and its over 1100 members provide 98% of the local exchange carrier access lines in the United States. Well over 200 of USTA's members also have interests, of varying types, in cable companies.

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[1]Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 93-215 and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service, CS Docket No. 94-28 <u>Report and Order and Further Notice of Rulemaking</u> (March 30, 1994) ("Order").

## I. CRITICISMS OF THE FCC'S RATE OF RETURN DETERMINATION ARE UNFOUNDED.

In their Petition for Reconsideration, CVI and Comcast characterize the 11.25 percent rate of return that the FCC is applying to cable companies on an interim basis as "wholly inadequate" (CVI at n.11.) and "far too low" (Comcast at 18.) CVI claims that cable operators face greater risk than the telephone companies and argues that the FCC is unjustified in setting an identical rate of return for the two industries. (CVI at n.11.) Comcast claims that any implication that telephone and cable companies face similar risks is an "absurd belief" that "flies in the fact of observable fact". (Comcast at 19.)

These views of Comcast and CVI concerning the relative levels of risk facing the local exchange telephone industry and the cable industry are mistaken. LECs face significant business risks as the local telephone market evolves to full competition. New competitors with significant resources and assets are entering into the provision of telephony services at a rapid rate, ensuring that competition will continue to grown in the LEC's business. On May 9, USTA submitted its comments in the FCC's review of the LEC price cap plan. In that filing, USTA documented the competition that local exchange carriers face, and will increasingly face, for the interstate services they provide. (USTA concentrated on these services because it is interstate offerings of the LECs that are within the FCC's jurisdiction.)

Part of USTA's price cap filing was an overview of the competition faced by LECs in the interstate market. That document, authored by Dr. Robert G. Harris, is attached because it is relevant to rebut Comcast's and CVI's claims. Dr. Harris concludes that "LECs currently face competition in many key service areas and that competition to LECs in full-network services is likely to emerge rapidly." (Harris at B-1.)

Dr. Harris' analysis is just one piece of the overwhelming evidence that local exchange competition is a reality, and a predominant factor in the minds of investors. In fact, the cable industry has announced plans to enter the telephone market in a significant way. These plans were applauded by FCC Chairman Hundt in remarks delivered on May 24, 1994 at a cable industry convention. In praising competition between the two industries, the Chairman stated:

> For example, I think cable can, and should, compete to provide local telephone services. That's what the cable system in Montgomery County, Maryland, where I live, proposes to do, and that's what Time Warner Cable proposes to do in Rochester, New York. ... In 1984, Congress barred telephone company entry into your business so that you would have further opportunity to grow without being quashed by the local telephone monopoly. Now, ten years later, it is time for your to take on those monopolies.

At a gathering a few weeks earlier, representatives from the cable industry indicated that the technology they need to provide telephony is ready for deployment. They stated that only regulatory barriers in the states prevented them from immediately entering the local exchange market. For example, during this NCTA Cable Technology tour, Time Warner Communications President Thomas Morrow predicted that cable would provide telephone services sooner than most people expect and stated: "The barrier is not technical. The problem is that many states still make it illegal to compete with the RBOCs. Nothing will happen without speedy action by regulators."

NARUC has responded to charges from the cable industry, like those quoted above, that state regulators are slowing local exchange service offerings by cable companies. NARUC showed that many states have lowered or eliminated the regulatory barriers to entry; significantly, over three quarters of the US population reside in states where some form of local telephone competition is permitted under the state regulatory framework. See May 19, 1994 Letter from NARUC Communications Committee Chairman Dean Miller to Senator Ernest F. Hollings (D., S.C.). Putting the NARUC information together with that from the cable labs tour, it becomes clear that neither significant technical nor regulatory barriers stand in the way of cable companies competing with the local exchange carriers.

USTA is not critical of the cable industry for its interest in expanding into telephony. Indeed, USTA has publicly expressed its support of a bill introduced in the House of Representatives containing a provision that would both eliminate regulatory barriers to entry in the local exchange market and permit local exchange carriers to provide video programming in their telephone service areas. But the cable industry cannot credibly claim that it faces significantly greater business risk than the telephone industry. Meaningful competition to cable in the delivery of video programming has developed in only limited areas. In its last report to Congress on the state of competition in the cable market, the FCC observed: "The Cable Act also sought competition to cable operators, however, and the competition within the video industry is just beginning to expand and include alternative multichannel providers." Competition, Rate Deregulation and the Commissions Policies Relating to the Provision of Cable Television Service 5 FCC Rcd. 4962, 4966 (1990). (The FCC has just initiated the process of updating its 1990 report.)

Comcast also states, without any factual basis, that the cable industry faces greater regulatory risk than the telephone industry because "regulators are generally perceived as protective of LECs, whereas they are seen as hostile to the cable companies". (Comcast at 20.) The regulatory risks that local exchange carriers face in a system that is moving from traditional public utility regulation to full competition are enormous. As USTA has demonstrated, the LEC industry faces the problem of how to deal with the large subsidies flowing to basic exchange rates from services that are increasingly competitive. These subsidies are part of a regulatory system built into the telephone rate design in this country over many years. See, Calvin S. Monson and Jeffrey H. Rohlfs, The $20 Billion Impact of Local Competition In Telecommunications (Strategic Policy Research, July 16, 1993). The artificial pricing structure created by regulators may well have been in the public interest at the time it was instituted. Indeed, universal telephone service was built upon these subsidies, but they cannot be sustained in a competitive market. Public policymakers must replace these subsidies with explicit support mechanisms that are competitively neutral and sustainable, with support contributions coming from all telecommunications service and equipment providers. Until such a solution is implemented in the regulatory arena, the local exchange industry faces immense regulatory risks.

On the other hand, the regulatory risks faced by the cable industry seem to be diminishing. Chairman Hundt indicated in his May 24 remarks that:

> As I mentioned before, our rules [for cable] set no cap for return on investment, no limit on profit or cash flow margins, and no set prices for ala carte offerings. ... I've had many discussions with industry leaders about the so-called 2% productivity offset. This is part of an outstanding Further Notice of Proposed Rulemaking and I cannot prejudge the record. But let me point out that we didn't adopt any such offset in our February decision. I don't know of any reason to adopt it now.

The Chairman's remarks have been widely interpreted in the press as extending the "olive branch" to the cable industry.

Comcast cannot credibly claim that a regulatory agency whose Chairman just made such an overture is "hostile to cable".

CVI and Comcast have presented no evidence in their Petitions for Reconsideration to show that the FCC's rate of return determination for the cable industry is not sound. In its Further Notice of Proposed Rulemaking in this docket, the Commission has invited interested parties to submit data on the cost of equity for the cable industry. (Order at ¶ 305.) It may be that Comcast will submit evidence at that time that a reasonable rate of return for the cable industry differs from the 11.25% that the FCC has prescribed for the interim. But the FCC should continue to reject any claims by the cable industry that a rate of return is unreasonable for them simply because it is the same figure that the FCC uses for the local exchange telephone industry. The LECs face very significant risks which investors take into account in evaluating the attractiveness of telephone investments.

Comcast also makes the claim that the FCC's rate of return finding is based upon "stale data". (Comcast at 20.) To the extent that Comcast is implying that the Commission's determination of a rate of return for the LEC industry is "stale", Comcast is mistaken. In the past several years, the FCC has carefully monitored the cost of capital, both equity and debt, for the local exchange carriers. It has adjusted that return when it found that conditions warranted it. The

Commission represcribed the interstate rate of return for the local exchange carriers in 1988 and again in 1991. In March of 1988, the FCC reviewed the situation as part of a decision to postpone the beginning of a represcription process until 1989. In late 1989, the Commission again confirmed that the return in effect at the time was in the zone of reasonableness for an additional year. At the end of 1990, the FCC represcribed the authorized return, lowering it to 11.25%. Finally, in July of 1992, the FCC revisited the issue and suspended the LECs obligation to make automatic filings under the Part 65 rules until the Commission completes its rewrite of these rules. The actions described above are a clear indication that the FCC continually monitors the return prescribed for the LECs to ensure that it is within the zone of reasonableness.

Particularly when it has an additional opportunity to present evidence in a few weeks, Comsat cannot credibly make a claim that a rate of return determination for the cable industry issued less than 3 months ago must now be reconsidered on the basis that it is "stale".

## II. A TRANSITION MECHANISM MAY BE NECESSARY, BUT THE FCC'S ULTIMATE GOAL MUST BE REGULATORY PARITY BETWEEN THE TELEPHONE AND CABLE "COST OF SERVICE" RULES.

On pages 11-14 of its Petition for Reconsideration, Comcast addresses what appears to be the cable industry's central objection to the FCC's "cost of service" decision. Many cable companies have massive amounts of goodwill, franchise costs, customer list payments, and other intangible assets on their books. These intangibles are the legacy of the high prices cable companies paid for their systems. Comcast itself gives an example of a system purchased for $428 million, of which only $114 million represented the <u>fair market value</u> of tangible assets used for providing cable service. (Comcast at 16.) Comcast estimates that the <u>net book value</u> of the tangible assets - i.e., the ratebase - to be $45 million. As Comcast observes, under rules that provide no recovery of intangibles, no matter how high the FCC sets the rate of return, this cable company will experience severe financial difficulties. (Comcast at 17.)

Rather than adopting a clear cut rule for ratebase treatment of intangible assets, the FCC adopted a series of presumptions. The Commission will presumptively allow into cable ratebase "those types of intangible costs that generally represent reasonable costs of providing service and that would be incurred under competition". (<u>Order</u> at ¶ 84.) In this category, the Commission includes franchise costs and customer lists.

The FCC then established another category of intangibles, including goodwill, that are presumptively disallowed from ratebase. However, cable companies may rebut that presumption and persuade local regulatory authorities to allow them to earn on goodwill. This set of presumptions is ambiguous, complex and probably unworkable in local rate setting proceedings.

USTA does not believe that it is reasonable to expect cable ratepayers to supply the cable companies with a return on large sums of intangible assets that are characteristic in that industry. In the past, many sellers of cable systems were made rich by transactions where buyers paid many times the value of the physical assets involved. Under no circumstances should any of these intangibles be included in ratebase.

Rather than creating a complex system of presumptions, the treatment of intangibles should be identical to that afforded to goodwill acquired by LECs. Pursuant to Part 32 of the FCC's rules, any portion of a purchase price that cannot be assigned to specifically identifiable property must be identified by the LEC as goodwill. The goodwill is then amortized to a "below-the-line" account. See 47 CFR §32.2007. This is a clear, simple and workable rule.

The fact remains that most of today's cable operators paid their acquisition prices prior to the regulation of the industry. The FCC itself acknowledges "the possibility that disallowance of any excess acquisition costs could have an adverse impact on the cable industry." (Order at n.178.) But an ongoing system of presumptions is not an effective answer to the Commission's concern. Implementing a transition in which pre-regulation intangibles would be amortized, followed by a clear rule excluding all intangibles from ratebase, is the better course. It would also fulfill Congress' direction to the FCC to reduce administrative burdens in cable regulation. (Order at ¶ 57.) The FCC notes that BellSouth and others previously made similar proposals to adopt an amortization as a transition mechanism in this docket. (Order at ¶ 63.)

If the Commission implements a transition mechanism, it should allow above-the-line amortization only of "pre-regulation" intangible assets over a reasonable time period. If it allows such a transition, the FCC must put the cable industry on notice that none of the intangible assets acquired after the passage of the Cable Act of 1992 can be included in ratebase or amortized above the line.[2]

In early 1988, the Commission ordered an amortization of the depreciation reserve deficiency that existed for the local exchange carriers. See Amortization of Depreciation Reserve Imbalances of Local Exchange Carriers, CC Docket No. 87-447, Report and Order ("Amortization Order") (January 21, 1988). That docket can, to some extent, serve as a model for the pre-regulation intangibles in the cable industry. However, the five year amortization period adopted for the reserve

[2]Of course, to the extent that any of the "pre-regulation" intangibles are attributable to the payment of excess acquisition premiums, that portion should also be excluded from rates.

deficiency is not appropriate for the cable intangible assets. Instead, the FCC could look to the Internal Revenue Service rules on the amortization of intangible assets as a guide on the timeframe for amortizing the cable assets. Section 197 of the IRS Code allows taxpayers to amortize intangible assets ratably over a fifteen year period, beginning with the month that the intangible is acquired. A copy of Section 197 is attached. (The IRS does not allow the amortization of "self-created" intangibles and neither should the Commission.)

The FCC would be able to set a uniform date on which all cable companies under cost of service regulation would begin the fifteen year amortization. In addition, the FCC should retain the right to review any amortization of pre-regulation intangibles that would cause a rate increase. In that situation, the FCC should lengthen the amortization period to mitigate the impact of the transition mechanism on ratepayers. When the FCC instituted the reserve deficiency amortization for LECs, a major consideration in choosing the five year amortization period was that "economic conditions, namely low inflation and decreases in revenue requirements resulting from changes in the tax laws permit[ted] more rapid reduction of the present large reserve deficiency amortization with less rate impact." (Amortization Order at ¶ 17.) In fact, the FCC was able to institute that amortization with "minimal upward pressure on rates". (Id.)

## III. REGULATORY PARITY BETWEEN THE CABLE AND TELEPHONE PRICE CAP RULES MUST BE IMPLEMENTED BY THE COMMISSION.

Bell Atlantic points out that the FCC's rules for cable companies - particularly the cable price cap plan - are more favorable in crucial respects than the rules for telephone companies. USTA agrees with Bell Atlantic that cable is subject to far fewer regulatory burdens. For example, CVI suggests that cable companies are treated unfairly because price cap LECs are permitted to earn more than 11.25 percent under the sharing mechanism. CVI is comparing apples and oranges. The proper comparison is the LEC price cap plan vs. the cable price cap plan. As Chairman Hundt points out, cable companies have no sharing provision in their price cap plan.

The FCC is in a unique position at this time to move to regulatory parity. It is actively considering both the telephone and cable price cap plans. USTA urges the Commission to correct the inequities between the two regulatory frameworks by reforming the LEC price cap plan as suggested in USTA's price cap comments.

Respectfully submitted,

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June 16, 1994

**CERTIFICATE OF SERVICE**

I, Robyn L.J. Davis, do certify that on June 16, 1994 copies of the Comments of the United States Telephone Association were either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the persons on the attached service list.

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## Unused Business Credits

**● ● *CCH Explanation***

expiration of the 15-year carryover period, there is an unused investment tax credit of $2,000 that expires. In the first tax year after expiration of the credit carryover period, the taxpayer may deduct $1,000 (50% of the $2,000 unused investment credit) of the investment tax credit downward basis adjustment.

The entire amount of both the unused targeted jobs credit (see ¶ 4803) and the alcohol fuels credit (see ¶ 4304) may be deducted. Because the alcohol fuels credit may not be carried beyond 1994, any alcohol fuels credit carryforward that is unused at the end of the 1994 tax year would be deducted in the following tax year. The deduction for the unused research credit (see ¶ 4362) is limited to 50% of the unused credit for a tax year beginning before January 1, 1990. Since no order for using these credits is provided, it is assumed that they should be allocated at the end of the carryforward period (or the last tax year beginning before 1994 for the alcohol fuels credit) according to the proportion that each credit bore to the general business credit in the unused credit year (see ¶ 4301).

***Example (2):*** In 1992, Corporation C's general business credit was $200,000, consisting of a $120,000 investment tax credit that required a Code Sec. 50(c) basis reduction, a $60,000 jobs credit, and a $20,000 research credit. At the end of 2006, $8,000 of this $200,000 general business credit is unused. To determine C's permissible deduction of the $8,000 unused general business credit carryforward for the year 2007, it will be assumed that an allocation will be made according to the proportion that each credit component bore to the general business credit in the unused credit year.

Investment tax credit = $120,000/$200,000 × 50% (for 50(c) basis reduction) × $8,000 = 60% × 50% × $8,000 math

plus

Jobs credit = $60,000/$200,000 × $8,000 = (taken in entirety) 30% × $8,000 = $2,400

plus

Research credit = $20,000/$200,000 × 50% × $8,000 = 10% × 50% × $8,000 = $400.

Therefore, of the $8,000 unused general business credit carryforward:

| | | |
|---|---|---|
| | $2,400 | investment tax credit |
| | $2,400 | job credit |
| + | $ 400 | research credit |
| | $5,[illegible]0 | may be deducted in the year 2007. |

If a taxpayer dies or ceases to exist before the expiration of the credit carryover period, the deduction is available in the tax year in which death or cessation occurs.—CCH.



***→ Caution: Code Sec. 197, below, as added by P.L. 103-66, generally applies to property acquired after August 10, 1993.←***

## [¶ 12,450] AMORTIZATION OF GOODWILL AND CERTAIN OTHER INTANGIBLES

'86 Code

Sec. 197 [1986 Code] (a) GENERAL RULE.—A taxpayer shall be entitled to an amortization deduction with respect to any amortizable section 197 intangible. The amount of such deduction shall be determined by amortizing the adjusted basis (for purposes of determining gain) of such intangible ratably over the 15-year period beginning with the month in which such intangible was acquired.

(b) NO OTHER DEPRECIATION OR AMORTIZATION DEDUCTION ALLOWABLE.—Except as provided in subsection (a), no depreciation or amortization deduction shall be allowable with respect to any amortizable section 197 intangible.

(c) AMORTIZABLE SECTION 197 INTANGIBLE.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this section, the term "amortizable section 197 intangible" means any section 197 intangible—

 

→ ***Caution: Code Sec. 197, below, as added by P.L. 103-66, generally applies to property acquired after August 10, 1993.***←

(A) which is acquired by the taxpayer after the date of the enactment of this section, and

(B) which is held in connection with the conduct of a trade or business or an activity described in section 212.

(2) EXCLUSION OF SELF-CREATED INTANGIBLES, ETC.—The term "amortizable section 197 intangible" shall not include any section 197 intangible—

(A) which is not described in subparagraph (D), (E), or (F) of subsection (d)(1), and

(B) which is created by the taxpayer.

This paragraph shall not apply if the intangible is created in connection with a transaction (or series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof.

(3) ANTI-CHURNING RULES.—

For exclusion of intangibles acquired in certain transactions, see subsection (f)(9).

(d) SECTION 197 INTANGIBLE.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this section, the term "section 197 intangible" means—

(A) goodwill,

(B) going concern value,

(C) any of the following intangible items:

(i) workforce in place including its composition and terms and conditions (contractual or otherwise) of its employment,

(ii) business books and records, operating systems, or any other information base (including lists or other information with respect to current or prospective customers),

(iii) any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item,

(iv) any customer-based intangible,

(v) any supplier-based intangible, and

(vi) any other similar item,

(D) any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof,

(E) any covenant not to compete (or other arrangement to the extent such arrangement has substantially the same effect as a covenant not to compete) entered into in connection with an acquisition (directly or indirectly) of an interest in a trade or business or substantial portion thereof, and

(F) any franchise, trademark, or trade name.

(2) CUSTOMER-BASED INTANGIBLE.—

(A) IN GENERAL.—The term "customer-based intangible" means—

(i) composition of market,

(ii) market share, and

(iii) any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers.

(B) SPECIAL RULE FOR FINANCIAL INSTITUTIONS.—In the case of a financial institution, the term "customer-based intangible" includes deposit base and similar items.

(3) SUPPLIER-BASED INTANGIBLE.—The term "supplier-based intangible" means any value resulting from future acquisitions of goods or services pursuant to relationships

→ *Caution: Code Sec. 197, below, as added by P.L. 103-66, generally applies to property acquired after August 10, 1993.* ←

(contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer.

(e) EXCEPTIONS.—For purposes of this section, the term "section 197 intangible" shall not include any of the following:

(1) FINANCIAL INTERESTS.—Any interest—

(A) in a corporation, partnership, trust, or estate, or

(B) under an existing futures contract, foreign currency contract, notional principal contract, or other similar financial contract.

(2) LAND.—Any interest in land.

(3) COMPUTER SOFTWARE.—

(A) IN GENERAL.—Any—

(i) computer software which is readily available for purchase by the general public, is subject to a nonexclusive license, and has not been substantially modified, and

(ii) other computer software which is not acquired in a transaction (or series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof.

(B) COMPUTER SOFTWARE DEFINED.—For purposes of subparagraph (A), the term "computer software" means any program designed to cause a computer to perform a desired function. Such term shall not include any data base or similar item unless the data base or item is in the public domain and is incidental to the operation of otherwise qualifying computer software.

(4) CERTAIN INTERESTS OR RIGHTS ACQUIRED SEPARATELY.—Any of the following not acquired in a transaction (or series of related transactions) involving the acquisition of assets constituting a trade business or substantial portion thereof:

(A) Any interest in a film, sound recording, video tape, book, or similar property.

(B) Any right to receive tangible property or services under a contract or granted by a governmental unit or agency or instrumentality thereof.

(C) Any interest in a patent or copyright.

(D) To the extent provided in regulations, any right under a contract (or granted by a governmental unit or an agency or instrumentality thereof) if such right—

(i) has a fixed duration of less than 15 years, or

(ii) is fixed as to amount and, without regard to this section, would be recoverable under a method similar to the unit-of-production method.

(5) INTERESTS UNDER LEASES AND DEBT INSTRUMENTS.—Any interest under—

(A) an existing lease of tangible property, or

(B) except as provided in subsection (d)(2)(B), any existing indebtedness.

(6) TREATMENT OF SPORTS FRANCHISES.—A franchise to engage in professional football, basketball, baseball, or other professional sport, and any item acquired in connection with such a franchise.

(7) MORTGAGE SERVICING.—Any right to service indebtedness which is secured by residential real property unless such right is acquired in a transaction (or series of related transactions) involving the acquisition of assets (other than rights described in this paragraph) constituting a trade or business or substantial portion thereof.

(8) CERTAIN TRANSACTION COSTS.—Any fees for professional services, and any transaction costs, incurred by parties to a transaction with respect to which any portion of the gain or loss is not recognized under part III of subchapter C.

(f) SPECIAL RULES.—

(1) TREATMENT OF CERTAIN DISPOSITIONS, ETC.—

*→ Caution: Code Sec. 197, below, as added by P.L. 103-66, generally applies to property acquired after August 10, 1993.←*



(A) IN GENERAL.—If there is a disposition of any amortizable section 197 intangible acquired in a transaction or series of related transactions (or any such intangible becomes worthless) and one or more other amortizable section 197 intangibles acquired in such transaction or series of related transactions are retained—

(i) no loss shall be recognized by reason of such disposition (or such worthlessness), and

(ii) appropriate ajdustments to the adjusted bases of such retained intangibles shall be made for any loss not recognized under clause (i).

(B) SPECIAL RULE FOR COVENANTS NOT TO COMPETE.—In the case of any section 197 intangible which is a covenant not to compete (or other arrangement) described in subsection (d)(1)(E), in no event shall such covenant or other arrangement be treated as disposed of (or becoming worthless) before the disposition of the entire interest described in such subsection in connection with which such covenant (or other arrangement) was entered into.

(C) SPECIAL RULE.—All persons treated as a single taxpayer under section 41(f)(1) shall be so treated for purposes of this paragraph.

(2) TREATMENT OF CERTAIN TRANSFERS.—

(A) IN GENERAL.—In the case of any section 197 intangible transferred in a transaction described in subparagraph (B), the transferee shall be treated as the transferor for purposes of applying this section with respect to so much of the adjusted basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor.

(B) TRANSACTIONS COVERED.—The transactions described in this subparagraph are—

(i) any transaction described in section 332, 351, 361, 721, 731, 1031, or 1033, and

(ii) any transaction between members of the same affiliated group during any taxable year for which a consolidated return is made by such group.



(3) TREATMENT OF AMOUNTS PAID PURSUANT TO COVENANTS NOT TO COMPETE, ETC.—Any amount paid or incurred pursuant to a covenant or arrangement referred to in subsection (d)(1)(E) shall be treated as an amount chargeable to capital account.

(4) TREATMENT OF FRANCHISES, ETC.—

(A) FRANCHISE.—The term "franchise" has the meaning given to such term by section 1253(b)(1).

(B) TREATMENT OF RENEWALS.—Any renewal of a franchise, trademark, or trade name (or of a license, a permit, or other right referred to in subsection (d)(1)(D)) shall be treated as an acquisition. The preceding sentence shall only apply with respect to costs incurred in connection with such renewal.

(C) CERTAIN AMOUNTS NOT TAKEN INTO ACCOUNT.—Any amount to which section 1253(d)(1) applies shall not be taken into account under this section.

(5) TREATMENT OF CERTAIN REINSURANCE TRANSACTIONS.—In the case of any amortizable section 197 intangible resulting from an assumption reinsurance transaction, the amount taken into account as the adjusted basis of such intangible under this section shall be the excess of—

(A) the amount paid or incurred by the acquirer under the assumption reinsurance transaction, over

(B) the amount required to be capitalized under section 848 in connection with such transaction.

Subsection (b) shall not apply to any amount required to be capitalized under section 848.

(6) TREATMENT OF CERTAIN SUBLEASE -For purposes of this section, a sublease shall be treated in the same manner as a lease . the underlying property involved.

[The next page is 27,335-3.]

→ *Caution: Code Sec. 197, below, as added by P.L. 103-66, generally applies to property acquired after August 10, 1993.* ←

(7) TREATMENT AS DEPRECIABLE.—For purposes of this chapter, any amortizable section 197 intangible shall be treated as property which is of a character subject to the allowance for depreciation provided in section 167.

(8) TREATMENT OF CERTAIN INCREMENTS IN VALUE.—This section shall not apply to any increment in value if, without regard to this section, such increment is properly taken into account in determining the cost of property which is not a section 197 intangible.

(9) ANTI-CHURNING RULES.—For purposes of this section—

(A) IN GENERAL.—The term "amortizable section 197 intangible" shall not include any section 197 intangible which is described in subparagraph (A) or (B) of subsection (d)(1) (or for which depreciation or amortization would not have been allowable but for this section) and which is acquired by the taxpayer after the date of the enactment of this section, if—

(i) the intangible was held or used at any time on or after July 25, 1991, and on or before such date of enactment by the taxpayer or a related person,

(ii) the intangible was acquired from a person who held such intangible at any time on or after July 25, 1991, and on or before such date of enactment, and, as part of the transaction, the user of such intangible does not change, or

(iii) the taxpayer grants the right to use such intangible to a person (or a person related to such person) who held or used such intangible at any time on or after July 25, 1991, and on or before such date of enactment.

For purposes of this subparagraph, the determination of whether the user of property changes as part of a transaction shall be determined in accordance with regulations prescribed by the Secretary. For purposes of this subparagraph, deductions allowable under section 1253(d) shall be treated as deductions allowable for amortization.

(B) EXCEPTION WHERE GAIN RECOGNIZED.—If—

(i) subparagraph (A) would not apply to an intangible acquired by the taxpayer but for the last sentence of subparagraph (C)(i), and

(ii) the person from whom the taxpayer acquired the intangible elects, notwithstanding any other provision of this title—

(I) to recognize gain on the disposition of the intangible, and

(II) to pay a tax on such gain which, when added to any other income tax on such gain under this title, equals such gain multiplied by the highest rate of income tax applicable to such person under this title,

then subparagraph (A) shall apply to the intangible only to the extent that the taxpayer's adjusted basis in the intangible exceeds the gain recognized under clause (ii)(I).

(C) RELATED PERSON DEFINED.—For purposes of this paragraph—

(i) RELATED PERSON.—A person (hereinafter in this paragraph referred to as the "related person") is related to any person if—

(I) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1), or

(II) the related person and such person are engaged in trades or businesses under common control (within the meaning of subparagraphs (A) and (B) of section 41(f)(1)).

For purposes of subclause (I), in applying section 267(b) or 707(b)(1), "20 percent" shall be substituted for "50 percent".

(ii) TIME FOR MAKING DETERMINATION.—A person shall be treated as related to another person if such relationship exists immediately before or immediately after the acquisition of the intangible involved.

(D) ACQUISITIONS BY REASON OF DEATH.—Subparagraph (A) shall not apply to the acquisition of any property by the taxpayer if the basis of the property in the hands of the taxpayer is determined under section 1014(a).

*→ Caution: Code Sec. 197, below, as added by P.L. 103-66, generally applies to property acquired after August 10, 1993.←*

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(E) SPECIAL RULE FOR PARTNERSHIPS.—With respect to any increase in the basis of partnership property under section 732, 734, or 743, determinations under this paragraph shall be made at the partner level and each partner shall be treated as having owned and used such partner's proportionate share of the partnership assets.

(F) ANTI-ABUSE RULES.—The term "amortizable section 197 intangible" does not include any section 197 intangible acquired in a transaction, one of the principal purposes of which is to avoid the requirement of subsection (c)(1) that the intangible be acquired after the date of the enactment of this section or to avoid the provisions of subparagraph (A).

(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including such regulations as may be appropriate to prevent avoidance of the purposes of this section through related persons or otherwise.